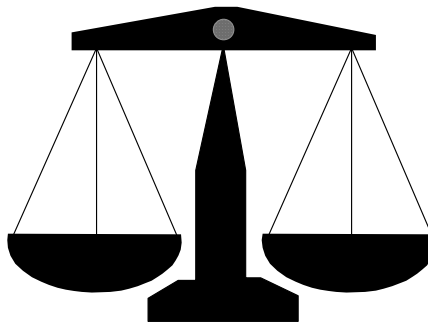


## SIGNIFICANT COURT CASES



### ***The Estate of Theodore F. Hagerman v. Indiana Dept. of State Revenue*** **771 N.E.2d 120 (Ind.Tax 2002)**

The Estate of Theodore F. Hagerman appealed a probate court ruling that the Estate had failed to make a valid Qualified Terminable Interest Property (QTIP) election. Under IC 6-4.1-2-4(d), the QTIP election allows the payment of inheritance tax to be delayed until the surviving spouse of the decedent dies. To qualify for the QTIP, the Tax Court noted there must be a writing that manifests “an affirmative, unequivocal intent to elect Indiana QTIP treatment.” Regulation 45 IAC 4.1-3-5(b)(4) provides the “form and content” that QTIP election must “substantially” follow. The Tax Court held that the Estate did not “attach a written election to the inheritance tax return that was substantially similar in form and content to that set forth” by 45 IAC 4.1-3-5(b)(4). Instead of substantially complying with the “form and content” of the regulation, the Estate “buried” the required writing on the schedule of beneficiaries. The Tax Court held for the Department, noting that the Estate failed to make “an affirmative statement that the election was being made pursuant to Indiana Code Section 6-4.1-3-7,” and that there was “no statement of understanding that the election was irrevocable, and no signature on the asserted election.” The Court also stated that even if it found the regulation was invalid, that nonetheless the Estate did not comport with the requirements of IC 6-4.1-3-7. On this point the Court highlighted the fact that it is “especially important” that an “affirmative, unequivocal expression of intent to elect QTIP status” be made. Regarding the other issue before the court—whether the Estate improperly deducted certain expenses on the inheritance tax return—the Court cited lack of ripeness for adjudication and thus declined to disallow the deductions.

### ***The Frame Station, Inc., d/b/a Framemakers IV v. Indiana Dept. of State Revenue*** **771 N.E.2d 129 (Ind.Tax 2002)**

One issue was before the Tax Court: whether or not the sale of custom framed art is taxable as a “retail unitary transaction.” Framemakers is in the custom framing business. Instead of paying in advance for the frame and framing service, Framemakers’ customers paid a “total price for the framing service and frame” upon final pick-up. Framemakers collected sales tax only on the frames, and not on the service. The Department argued that both the frame and the framing service were taxable as a “retail unitary transaction” under IC 6-2.5-1-1(a) and IC 6-2.5-4-1(e). The former statute defines a unitary transaction as including “all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated.” The Tax Court characterized the latter statute, IC 6-2.5-4-1(e), as standing for “the imposition of sales tax on otherwise nontaxable services when the services are performed ... prior to the transfer of the property to the transferee.” Thus the Tax Court said the case turned on the timing of the framing service—was it “before or after” the frame was transferred to the customer? The Department argued, and the Tax Court agreed, that Framemakers “frames a customer’s art *before* it transfers the frame to the customer.” Since Framemakers’ customers paid for the framed art when they picked up the completed framing, the Court held that “Framemakers’ services are performed prior to the transfer of property and constitute taxable retail unitary transactions....”

***Bradley J. Rhoades v. Indiana Dept. of State Revenue***  
**774 N.E.2d 1044 (Ind.Tax 2002)**

In 1998, Indiana resident Bradley Rhoades bought a motor vehicle in Florida. Mr. Rhoades paid Florida's 6% sales tax on the vehicle at the time of purchase. Later that same year Mr. Rhoades titled the vehicle in Indiana, and was assessed Indiana's 5% use tax on the purchase price. The Tax Court noted that Indiana's use tax is "functionally equivalent to a sales tax" and elsewhere stated that the use tax statute is in place to "ensure that nonexempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed." The Department relied on IC 6-2.5-3-5(b), arguing that the statute disallows a tax credit with regards to a vehicle "purchased in other states that are required to be titled for use in Indiana." The Court denied Rhoades's motion for summary judgment on the issue of use tax exemption. However, the Court did find Rhoades's other argument persuasive—namely, since he had already paid sales tax to another state, then Indiana's use tax on his out-of-state vehicle purchase runs afoul of the U.S. Constitution's Commerce Clause. The essence of Rhoades's argument was that "Indiana's use tax discriminates against interstate commerce" and constitutes multiple taxation since Rhoades in effect paid tax twice—6% Florida sales tax on the purchase price, and later an additional 5% Indiana use tax on the purchase price. The Court explained that a "state tax impermissibly discriminates against interstate commerce when the state's taxing power effectively increases the tax burden for out-of-state transactions, thereby coercing taxpayers to conduct intrastate rather than interstate business." The Court ascertained that this in fact occurred in Rhoades's case, since he was "effectively assessed tax on the purchase price of his vehicle at a rate of 11%," and held for Mr. Rhoades.

***Leland H. Stump v. Indiana Dept. of State Revenue***  
**777 N.E. 2d 799 (Ind.Tax 2002)**

Leland Stump bought two vans and had a company make handicap-use alterations to the vans (Mr. Stump is an amputee). The controversy before the court was whether Stump's purchase of "two handicap-modified vans are exempt from sales tax under Indiana's medical equipment exemption ... 6-2.5-5-18." The Department argued that only the "special handicap equipment" was exempt, but that the vans were not. Stump argued that both the vans and the handicap equipment were exempt. The Tax Court held that "[t]here is nothing inherently healing or remedial about a van that would make it appropriate only for handicapped people" and, elsewhere, that only the "special handicap equipment which enables Mr. Stump to continue to drive" is exempt under IC 6-2.5-5-18(a).

***1 Stop Auto Sales, Inc. v. Indiana Dept. of State Revenue***  
**779 N.E.2d 614 (Ind.Tax 2002)**

1 Stop is a vehicle dealership that offers "buy-here-pay-here" sales. Customers can buy a vehicle with "no money down" on an installment contract. Under that financing arrangement, no sales tax was collected from "Consumers on the purchase price of the vehicle at the time of the sale." Instead, 1 Stop loaned "the sales tax to the Consumers" and then remitted "the entire amount of sales tax due to the Department." If a purchaser defaulted on such a contract, 1 Stop characterized "the receivables from these contracts as uncollectible, or bad debt." Two issues were before the Tax Court. The first involved whether the Tax Court had jurisdiction over a 1993 claim for refund by 1 Stop. The Court found that 1 Stop filed its 1993 claim for refund nine months past the deadline and dismissed the claim. The second issue involved the bad debt deduction and whether 1 Stop was entitled to it under IC 6-2.5-6-9. 1 Stop argued "it is entitled to a bad debt deduction because it has remitted sales tax on retail sales for which it has not collected sales tax from the Consumers, and it has subsequently written those receivables off as bad debt for federal tax purposes." The Department argued, unpersuasively, that 1 Stop could not avail itself of the bad debt deduction "where it has loaned sales tax to the Consumers and not collected it." The Tax Court disagreed, finding that the Indiana Code "does not prohibit a retail merchant from loaning sales tax to a purchaser under a valid installment contract." The Tax Court also found the Department's estoppel argument failed, since the Form ST-108 did not "bar" 1 Stop from "claiming a bad debt deduction." Finally, the Court examined how to determine a bad debt deduction amount. The Court held that the "Department need only determine the amount of 1 Stop's Indiana receivables that it claimed as bad debt for federal tax purposes to determine the amount of its deduction under the [Indiana] Bad Debt statute" and remanded for the Department to determine 1 Stop's refund amount.

***Preston H. Ford v. Indiana Dept. of State Revenue***  
**779 N.E.2d 1274 (Ind.Tax 2002)**

Ford's case involved Indiana's Controlled Substance Excise Tax ("CSET"). Ford argued two things on appeal—that the CSET assessment violated the double jeopardy clause of the U.S. Constitution and that the Department "unreasonably delayed" holding his administrative tax hearing. The Tax Court rejected both arguments. The Court noted that the CSET assessment is "itself a judgment," but that the Department's jeopardy attached *before* Ford's criminal trial jeopardy attached. The Department's jeopardy attached "in December 1992 when the Department issued Ford the CSET assessment" and his criminal jeopardy attached "in 1994 when the trial court accepted Ford's guilty plea." The Court concluded that "[b]ecause Ford's CSET assessment was the first attachment of jeopardy, it did not violate his protection against double jeopardy." Regarding any delay in the hearing process, the Court stated that the "law provides no remedy for a delay of hearing ... nor does it expressly link the validity of a CSET assessment to the timing of a protest hearing."

***Enterprise Leasing Company of Chicago, et al., v. Indiana Dept. of State Revenue***  
**779 N.E.2d 1284 (Ind.Tax 2002)**

Enterprise Leasing involved various "nonresident corporations with corporate headquarters located outside of Indiana" which were in the motor vehicle leasing business. The lessees exercised "complete control over the use and location of the leased vehicles, including the right to designate an independent automobile dealer from which they can pick up their vehicles." Lessees bore the responsibilities of any repair work, insuring, licensing, and registering of the vehicles. The Court first examined whether Indiana "can tax the Petitioners' gross income earned as a result of the leases at issue," with the disagreement between the Department and the Petitioners turning on whether the gross income was "derived from 'sources within Indiana'" under IC 6-2.1-2-2(a). The Tax Court stated a three-part test for analyzing the derivation of gross income. The first part involves the "critical transaction" (i.e., to "isolate the transaction giving rise to the income"); the second part is the "business situs" (i.e., did "the Petitioners have a physical presence in, or significant business activities within" Indiana); and the third part, "tax situs" (i.e., figuring out "whether the Indiana activities are related to the critical transaction and are more than minimal ...."). The Court's reasoning and holding turned on part two—business situs. The Court stated that "ownership, leasing, or rental" must be *active* "for the establishment of a 'business situs' in Indiana." The Petitioners argued persuasively to the Court that they were "nothing more than passive participants in the ownership, leasing, and rental of property" within Indiana. Therefore the Court held the Petitioners' "income is not subject to Indiana's gross income tax." The Court also examined the issue of the Petitioners' property factor numerators. The Department's contention was since the "Petitioners owned the leased vehicles, they were properly included in the Petitioners' property factor numerators" per IC 6-3-2-2(c). The Court disagreed with the Department's interpretation of IC 6-3-2-2(c), finding that the "legislature intended that property 1) be owned or rented by the taxpayer; and 2) be used by the taxpayer in Indiana."

***U-Haul Co. of Indiana, et al., v. Indiana Dept. of State Revenue***  
**784 N.E.2d 1078 (Ind.Tax 2002)**

The Petitioners in this case were comprised of several different U-Haul Companies, which rent various moving equipment. The Tax Court put the issue before it as whether the Petitioners were "liable for gross income tax on 100% of rental amounts when they did not receive 100% of these amounts." The Court stated that the "U-Haul System" is: Fleet Owners; Rental Companies (the Petitioners' comprised this group); Rental Dealers; and U-Haul International (UHI). Under the U-Haul System, the "four groups are bound together through a series of contractual relationships" and "each member of the U-Haul System receives only a percentage of the total rental receipts collected by the Rental Dealers from the public." Additionally, the "form, terms, and conditions of all contracts" were controlled by UHI. The Petitioners paid gross income tax on "their contractual percentage of the rental amount collected by the Rental Dealers located in their Indiana territories." The Petitioners theory was that they were "not liable for gross income tax on 100% of rental amounts because they themselves did not have a beneficial interest in 100% of the rental amounts." The Tax Court examined several statutes, along with the relationship of the Petitioners to the Rental Dealers, and the Petitioners to UHI. The Court agreed with the Department that the Rental Dealers "collected rental amounts as agents" for the Petitioners, but the Court quickly noted the "Petitioners, in turn acted in an agency capacity." The Court reached that conclusion by examining the fact that, among other things, UHI "specified the terms and conditions of the Petitioners' contracts

with Rental Dealers.” Thus the Court found that the Petitioners were “subject to UHI’s control.” The Court held against the Department, stating the “Petitioners do not have any right or beneficial interest in the rental amounts collected by the Indiana Rental Dealers beyond their contractually specified percentage” and that the Petitioners were a “conduit for the rental amounts to pass to UHI and did not have a beneficial interest in 100% of the rental amounts.”

***Subaru-Isuzu Automotive, Inc. v. Indiana Dept. of State Revenue***  
**782 N.E.2d 1071 (Ind.Tax 2003)**

The Tax Court stated that two issues were before it: (1) the propriety of adding back to Subaru’s adjusted gross income computation the property taxes that were, for federal tax, capitalized as inventory costs; and (2) whether IC 6-3-2-2.6 requires Subaru to make adjustments to Subaru’s “net operating loss by the amount of its adjusted gross income modifications each year it used its net operating loss.” The Department believed that Subaru had “incorrectly determined its Indiana AGI and supplemental net income tax liabilities” for the years in question. The Court further noted that the Department determined “that when Subaru calculated its Indiana tax liabilities, it failed to add back the property taxes it had capitalized as inventory costs for federal tax purposes” and additionally the Department “maintained that Subaru had erroneously calculated its net operating loss (NOL) deductions.” Subaru argued that inventory costs were exclusions from gross income, and therefore that “its capitalized property taxes are *not* deductions from gross income and are therefore are not subject to the federal deduction add-back” portion of IC 6-3-1-3.5. The Department argued “deduction” in the Indiana Code “encompasses both exclusions *and* deductions taken for federal tax purposes.” The Court held that the Department was “incorrect.” The Court stated that “Article 3 of Indiana’s tax code incorporates by reference provisions of the Internal Revenue Code” and that “[f]ederal law clearly draws a legal distinction between an exclusion from gross income and a deduction from gross income.” Since federal law views the capitalized property taxes as exclusions, they were “not subject to the deduction add-back provision” of the Indiana Code. Regarding the NOL issue, the Court again found for Subaru, holding that IC 6-3-2-2.6(b) “instructs corporations to apply the AGI modifications required under” Indiana law “for the year in which each NOL was *incurred*, not the year each NOL was used.”

***Indiana Dept. of State Revenue v. Interstate Warehousing, Inc.***  
**783 N.E.2d 248 (Ind.2003)**

Interstate Warehousing (“Interstate”) runs warehouses that use “electricity to liquefy ammonia” to refrigerate the perishables stored at the warehouses by Interstate’s customers. Interstate argued that it should not have to pay taxes on the electricity it purchased for refrigeration. The Indiana Supreme Court examined Interstate’s use of liquid ammonia for refrigeration purposes, noting that Interstate used a “closed loop distribution system to lower the temperature of the air in the storage rooms.” Interstate “charges its customers based on the temperature that is required to be maintained in the refrigerated storage area and the quantity of perishables that the customer delivers.” The Supreme Court ruled against Interstate, finding that it was not “engaged in the ‘production of other tangible personal property’” and that it was not “in the business of ‘manufacturing, processing, refining, ....’” The Court noted that Interstate provided a service and did not make a “distinct marketable good.”

***1 Stop Auto Sales, Inc. v. Indiana Dept. of State Revenue***  
**785 N.E.2d 672 (Ind.Tax 2003)**

Upon 1 Stop’s request the Tax Court revisited the issue of the determination of the bad debt deduction amount under IC 6-2.5-6-9. In the first 1 Stop case the Court had stated that the “Department need only determine the amount of 1 Stop’s Indiana receivables that it claimed as bad debt for federal tax purposes to determine the amount of its deduction under the [Indiana] Bad Debt statute.” The Court clarified that earlier position, stating now “for the purposes of Indiana’s Bad Debt statute, 1 Stop may deduct an amount equal, in part, to the amount of its uncollectible Indiana receivables it removed from its books as a loss for federal tax purposes, not merely the amount it deducted as federal bad debt.” On August 1, 2003, the Indiana Supreme Court granted the Department’s Petition for Review of this decision (Cause No. 49-S-10-0308-TA-358).